

IT 03-1

Tax Type: Income Tax

Issue: Responsible Corporate Officer – Failure to File or Pay Tax

**STATE OF ILLINOIS
DEPARTMENT OF REVENUE
OFFICE OF ADMINISTRATIVE HEARINGS
CHICAGO, ILLINOIS**

**THE DEPARTMENT OF REVENUE
OF THE STATE OF ILLINOIS**

v.

**JOHN DOE,
Taxpayer**

No. 02-IT-0000
FEIN 00-0000000
Period 2/Q/00, 3/Q/00

**Ted Sherrod
Administrative Law Judge**

RECOMMENDATION FOR DISPOSITION

Appearances: Special Assistant Attorneys General Jessica Arong and Rick Walton on behalf of the Illinois Department of Revenue; Gary B. Hurt, Esq. of the Law Offices of Gary B. Hurt, on behalf of John Doe.

Synopsis:

This matter is before this administrative tribunal pursuant to John Doe's protest of Notice of Deficiency No. 0000 (hereinafter the "NOD"), as responsible officer of ABC Inc. (hereinafter "ABC"). The NOD represents a penalty liability for withholding taxes for the second and third quarters of 2000. A hearing was held on this matter on October 2, 2002, with John Doe, Vice President of Finance and Administration, and Joe Blow, Vice President of Operations providing oral testimony. Following submission of all evidence and a review of the record, it is recommended that the NOD be finalized as

issued. In support of this recommendation, the following “Findings of Fact” and “Conclusions of Law” are made.

Findings of Fact:

1. The Department’s prima facie case, inclusive of all jurisdictional elements, was established by the admission into evidence of NOD No. 0000 dated November 15, 2001, issued against John Doe, showing withholding tax liability for ABC in the amount of \$11,498.22 for the second and third quarters of 2000.¹
2. ABC is an Illinois domiciled corporation located in Anywhere, Illinois, and is engaged in the business of making home, home improvement, credit card, automobile and other loans secured by mortgages to customers with marginal credit ratings and selling these loans in the secondary market. Tr. pp. 16, 17, 43, 44, 88, 89.
3. Ron Doe is the President and owner of ABC; he also owns 100% of the stock of this corporation. Tr. pp. 23, 44.
4. John Doe (hereinafter also referred to as “taxpayer”) is the Vice President of Finance and Administration for ABC, and has been in charge of all financial accounting (including the preparation of all financial statements), tax and administrative operations (including human resources) of the company since he became employed by the company, in 1987; prior to joining ABC, the taxpayer was an outside accountant for the company. Tr. pp. 15, 21, 22, 25.
5. Joe Blow is the Vice President of Operations for ABC; prior to becoming the Vice President of Operations, Mr. Blow served as the company’s Director of Operations;

¹Unless otherwise noted, findings of fact apply to the tax periods 2/Q/00 and 3/Q/00.

his duties include originating loans and selling them in the secondary market, and managing the company's employees. Tr. pp. 45, 46, 89.

6. Prior to and during the period at issue, the taxpayer was responsible for the preparation and filing of IL 941 withholding tax returns and checks to pay withholding taxes due were signed by the taxpayer; he prepared and filed IL 941 returns for the periods 2/Q/00 and 3/Q/00. Tr. pp. 21, 22, 30, 37, 38, 44, 45, 64, 65; Dept. Ex. 3.
7. ABC deposited the monies it collected from the sale of loans in the secondary market into the company's bank accounts, and funds from these accounts were then used to pay salaries and other obligations. Tr. pp. 26, 27, 46.
8. The taxpayer and Ron Doe, ABC's President, had the authority to sign checks drawn on ABC's bank accounts before and during the tax periods in controversy; these accounts were set up by the taxpayer for the company. Tr. pp. 25, 26, 27, 28, 31, 32, 64, 112, 113.
9. Immediately prior to his resignation from the company in December, 2000, taxpayer gave Mr. Ron Doe unexecuted checks drawn to pay past due Illinois withholding taxes; however, Mr. Ron Doe failed to execute and deliver these checks to the Department. Tr. pp. 53, 54, 98, 99.
10. The taxpayer was aware during and after 1999 that ABC's business had declined and that the company was having serious cash flow problems. Tr. pp. 25, 26, 42, 43, 45.
11. Prior to and during the periods at issue, the taxpayer had personal knowledge that ABC had not been paying, in a timely manner, withholding taxes due as shown on returns he prepared; the taxpayer brought these compliance lapses to the attention of

Mr. Ron Doe in August, 1999, and asked him to pay back loans from the company in amounts sufficient to pay delinquent withholding taxes. Tr. pp. 28, 29, 30, 31; Taxpayer Ex. A, B, C.

12. After the taxpayer had personal knowledge of ABC's unpaid Illinois tax liabilities for delinquent withholding taxes, and while advising that all delinquent taxes be paid, the taxpayer paid salaries to himself and other employees, and allowed ABC to pay other corporate debts and liabilities, including personal liabilities of Mr. Ron Doe, which were paid for using corporate funds; some of these payments were made during the second and third quarters of 2000. Tr. pp. 25, 26, 31, 32, 45, 46, 47, 48, 49, 51, 52, 53, 54, 55, 57, 58, 59, 61, 62, 63, 80, 81, 82, 83, 91, 92, 93, 94, 95, 96; Taxpayer Ex. A, B, C.

13. After he had personal knowledge of ABC's Illinois tax liabilities, taxpayer continued to draw a salary from ABC before and during the second and third quarters of 2000. Tr. pp. 29, 30, 85, 86.

Conclusions of Law:

The sole issue to be decided in this case is whether John Doe should be held personally liable for the unpaid withholding tax of ABC Inc. ("ABC"). The personal liability penalty is imposed by Section 3-7 of the Uniform Penalty and Interest Act ("UPIA"), which provides as follows:

(a) Any officer or employee of any taxpayer subject to the provisions of a tax Act administered by the Department who has the control, supervision or responsibility of filing returns and making payment of the amount of any trust tax imposed in accordance with that Act and who willfully fails to file the return or to make the payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of the tax unpaid by the taxpayer including interest and penalties

thereon. The Department shall determine a penalty due under this Section according to its best judgment and information, and that determination shall be prima facie correct and shall be prima facie evidence of a penalty due under this Section.
35 ILCS 735/ 3-7(a)

It is clear under the statute that personally liability will be imposed only upon a person who: (1) is responsible for filing corporate tax returns and/or making the tax payments; and (2) “willfully” fails to file returns or make payments.

The admission into evidence of the NOD establishes the Department’s *prima facie* case with regard to both the fact that John Doe was a “responsible” officer and the fact that he “willfully” failed to file and/or pay. Branson v. Department of Revenue, 168 Ill. 2d 247, 262 (1995).² Once the Department has established a *prima facie* case, the burden shifts to the taxpayer to overcome the Department’s case. Masini v. Department of Revenue, 60 Ill. App. 3d 11 (1st Dist. 1978).

Section 3-7 of the UPIA does not define “responsible” person or “willful” conduct. However, the Illinois Supreme Court, in cases wherein it has considered personal liability, has referred to interpretations of similar language in Section 6672 of the Internal Revenue Code (26 USCA §6672). Branson v. Department of Revenue, *supra*; Department of Revenue v. Heartland Investments, Inc., 106 Ill. 2d 19 (1985); Department of Revenue v. Joseph Bublick & Sons, Inc., 68 Ill. 2d 568 (1977).

² In Branson v. Department of Revenue, 168 Ill. 2d 247 (1995), the Illinois Supreme Court held that the admission of the Notice of Penalty Liability into evidence established all of the statutory requirements for the imposition of the penalty, including willfulness. While the Court was addressing §452 ½ (which is also section 13 ½ of the Retailers’ Occupation Tax Act, 35 ILCS 120/1 *et seq.*), rather than section 3-7 of the Uniform Penalty and Interest Act (“UPIA”), a comparison of all of these provisions reveals that they are almost identical. All of these provisions enumerate corporate officer and employee penalty liability. Therefore, a similar analysis of Section 3-7 of the UPIA, based on the court’s conclusions may be made. Frowner v. Chicago Transit Authority, 25 Ill. App. 2d 312 (1st Dist. 1960).

Section 6672 imposes personal liability on corporate officers who willfully fail to collect, account for, or pay over employees' social security and Federal income withholding taxes.

In determining whether an individual is a responsible person, the federal courts have indicated that the focus should be on whether that person has significant control over the business affairs of a corporation and whether he or she participates in decisions regarding the payment of creditors and disbursement of funds. Monday v. United States, 421 F. 2d 1210 (7th Cir. 1970), cert. denied, 400 U.S. 821 (1970). The courts have considered specific facts in determining whether individuals were "responsible" for the payment of employee taxes, to wit: 1) the duties of the officer as outlined in the corporate by-laws; 2) the ability of the individual to sign checks of the corporation; 3) the identity of the officers, directors and shareholders of the corporation; 4) the identity of individuals who hired and fired employees and 5) the identity of the individuals in control of the financial affairs of the corporation. *Id.*; Gephart v. United States, 818 F. 2d 469 (6th Cir. 1987); Peterson v. United States, 758 F. Supp. 1209 (N.D. Ill. 1990). Liability attaches to those with the power and responsibility within the corporate structure for seeing that the taxes are remitted to the government. *Id.*

With regard to Mr. Doe, the testimony and evidence admitted at the evidentiary hearing clearly shows that Mr. Doe was a responsible party under the statute. The record in this case shows that Mr. Doe was the Vice President of Finance and Administration during the entire tax period in controversy. Tr. pp. 17, 20. It also reveals that he was responsible for overseeing the company's financial affairs from the inception of the company. Tr. pp. 15, 20, 21, 22, 25. The filing of payroll taxes was the exclusive

responsibility of Mr. Doe. Tr. pp. 21, 22, 30, 37, 38, 64, 65, 66; Dept. Ex. 3. Indeed, Mr. Doe was in fact responsible for paying all of the corporation's bills, and most of the checks drawn on the company's bank accounts were signed by him. Tr. pp. 25, 26, 30, 31, 32. Moreover, Mr. Doe was in charge of hiring and firing employees, since he supervised the accounting staff and the company's human resources activities. Tr. pp. 20, 21.

Mr. Doe testified that there were no manuals or other documents that enumerated what duties and responsibilities were vested in him as the Vice President of Finance and Administration. Tr. p. 23. However, the vice president of finance of a corporation is usually charged with the complete financial management of the corporation and there is no reason to assume that this was not the case here. In fact, Mr. Doe's testimony shows that he was indeed in charge of ABC's financial affairs. Tr. p. 15 ("I was in charge of all tax, accounting and administrative operations"). As Vice President of Finance and Administration, his duties included setting up the company's bank accounts, preparing all of the company's financial statements and tax returns, paying the company's expenses, and supervising the company's accounting staff. Tr. pp. 20, 21, 22, 24, 25, 26, 27, 28, 30, 31, 64.

Mr. Doe testified that he established the company's bank accounts, and had complete check writing authority prior to and during the tax periods at issue here. Tr. pp. 25, 26, 27, 28, 30, 31, 64. There is no evidence in the record that checks signed by him had to be countersigned by the company's president.

The ability to sign corporate checks is a significant factor in determining whether a person is a responsible party because it generally comes with the ability to choose

which creditors are paid. Gold v. United States, 506 F. Supp. 473 (D.C.N.Y. 1981), aff'd, 671 F. 2d 492 (2d Cir. 1981). In continuing to sign checks for expenses other than the withholding tax deposits during the tax periods at issue, Mr. Doe was in fact participating in decisions regarding payment of creditors and disbursal of funds, signifying that he was indeed a responsible officer of ABC.

Throughout his testimony, Mr. Doe attempted to underplay his authority over the payment of withholding taxes during the tax periods in controversy. Mr. Doe owned no voting stock in the company. Tr. p. 24. All of the company's voting stock was owned by the company's President, Jeffrey B. Ron Doe. Tr. p. 44. After 1999, when the company began having financial difficulties, Mr. Ron Doe gave instructions regarding how cash should be utilized to extinguish the company's debts. Tr. pp. 45, 46, 47, 48, 49. He would periodically review bills submitted by Mr. Doe and decide which ones Mr. Doe should pay. *Id.* According to both Mr. Doe and Mr. Blow, the company's Vice President of Operations, Mr. Ron Doe refused to pay Illinois payroll taxes for the tax periods in controversy. Tr. pp. 51, 52, 53, 54, 93, 94, 98, 99.

John Doe's testimony as to his lack of responsibility for ABC's payroll tax compliance omissions is self-serving. For this reason, and because Mr. Doe failed to call Mr. Ron Doe as a witness to corroborate his claims, I do not find his testimony to be entirely credible. Moreover, as pointed out in Howard v. United States, 82-2 USTC ¶ 9567 (ND Tex. 1982), aff'd, 711 F. 2d 729 (5th Cir. 1983), a case construing IRC sec. 6672, in determining whether Mr. Doe was a responsible officer, "(T)he question is not whether" Mr. Doe "exercised the power he possessed, but rather what power he possessed." Howard at 2. Mr. Doe was ABC's Vice President of Finance and

Administration. He was in charge of all tax, financial and administrative operations of the company before and during the tax periods in controversy. He had the authority to sign checks drawn on ABC's bank accounts, and there is no evidence that these checks needed to be countersigned. Accordingly, it is clear that Mr. Doe possessed the ability to refuse to sign checks paying creditors other than Illinois unless and until the taxes held in trust were paid over to the state. As Vice President of Finance and Administration, he was under a duty to refrain from favoring other creditors over the state. Howard at 2. Mr. Ron Doe, as chief executive officer, may have demanded that other creditors be preferred over the state. Tr. pp. 61, 62. Indeed, he may have threatened to remove Mr. Doe's power if Mr. Doe performed the statutory duty he was under to pay over the withholding taxes to Illinois. *Id.* Mr. Ron Doe, as Chief Executive Officer, may have in some sense been an even more responsible person than Mr. Doe. However, the courts have repeatedly held that there may be more than one responsible person in a corporation. Monday v. United States, *supra*; Williams v. United States, 931 F. 2d 805, 810 n.7 (11th Cir. 1991); Roth v. United States, 779 F. 2d 1567, 1571 ("There is no dispute ... that more than one person may be a 'responsible person' for an employer"). Accordingly, the fact that Mr. Ron Doe may have been "responsible" in no way impinges on the fact that Mr. Doe was himself a responsible person within the meaning of the 35 ILCS 735/3-7. Howard at 2; Neckles v. United States, 579 F. 2d 938 (5th Cir. 1978).

In sum, based on the testimony and evidence admitted at the evidentiary hearing, I must conclude that John Doe had significant control over the financial affairs of ABC during the entire period covered by the NOD. Moreover, by signing checks, he actively participated in the payment of creditors and disbursement of funds. These facts are sufficient

to establish that Mr. Doe was a responsible person under the relevant case law cited above. Accordingly, Mr. Doe has failed to rebut the Department's *prima facie* case that he was a responsible person under section 3-7 of the Uniform Penalty and Interest Act, 35 ILCS 735/3-7.

A second element, the willful failure to pay taxes, must be shown in order to impose personal liability in this case. *Id.* The Department presents a *prima facie* case for willfulness with the introduction of the NOD into evidence. Branson, *supra*. The burden then is on the responsible party to rebut the presumption of willfulness. *Id.*

As stated in Newsome v. United States, 431 F. 2d 742 (5th Cir. 1970), willfulness does not require a criminal or other bad motive on the part of the responsible person. All that must be shown is a voluntary, conscious and intentional failure to collect, truthfully account for, and pay over the taxes that are withheld from the company's employees. *Id.* at 745. Accordingly, the subjective state of mind of the responsible officer is not determinative.

Willfulness as used in 35 ILCS 735/3-7 may be indicated where there is a reckless disregard for obvious or known risks. Monday, *supra*. Willfulness also includes "failure to investigate or to correct mismanagement after having notice that withholding taxes have not been remitted to the Government." Peterson v. United States, 758 F. Supp. 1209, 1217 (N.D. Ill. 1990). A person also acts willfully in failing to pay delinquent taxes if he prefers other creditors to the State. Heartland Investments, *supra*.

John Doe's conduct was willful under each of the above tests. Mr. Doe admitted during direct testimony that he was aware that state withholding taxes were not being timely paid as early as August, 1999. Tr. pp. 28, 29. While Mr. Doe objected to the

company's continuing failure to pay taxes, no evidence was presented at the hearing to show what steps Mr. Doe took to correct ABC's mismanagement.³ Compliance lapses during the second and third quarters of 2000 may have resulted from Mr. Ron Doe's failure to repay loans from the company and his insistence that his personal obligations be paid before anything else. Tr. pp. 52, 53, 57, 58. However, no evidence was presented to show any attempt by Mr. Doe to retain enough money in the company's accounts to cover the unpaid withholding taxes.

Moreover, Mr. Doe continued to prepare and sign checks for expenses other than payroll taxes even though he knew that the payroll taxes had not been paid. Checks he signed after the company's failure to timely pay withholding taxes in 2000 included checks to pay company health insurance premiums and Mr. Ron Doe's personal credit card bills and car notes. Tr. pp. 57, 58, 59, 60, 61, 62. According to trial testimony, when asked why he continued to insist that obligations other than withholding taxes be paid, Mr. Ron Doe responded: "(Y)ou guys don't need to worry about it because I'm going to be the one responsible for the payroll taxes in the long run anyway." Tr. p. 94.

In relying on such assurances made to him by Mr. Ron Doe, Mr. Doe recklessly disregarded the obvious risk that taxes due the state would subsequently not be paid. This risk was clear to Mr. Doe in 2000 since, beginning in 1999, Mr. Ron Doe had repeatedly failed to pay withholding taxes when due. Such reckless disregard for obvious and known risks is a clear indicia of willfulness. Monday, *supra*. Accordingly, for this

³ While Mr. Doe testified that he resigned for one month in 1999, in part because of ABC's compliance lapses, there is no documentary evidence in the record to support this claim. Moreover, as pointed out by the Department in its closing arguments, Mr. Doe's purported resignation is completely inconsistent with his claim that he complied with Ron Doe's demands because he feared being fired. Tr. pp. 116, 117, 118. Because of the self serving nature of his testimony concerning his resignation, and the complete lack of corroborating documentary evidence, I do not find his claim that he resigned to be credible, and have given this evidence no weight in reaching a determination.

reason, and for the reasons enumerated above, I find that the taxpayer has failed to rebut the Department's *prima facie* case that he willfully failed to pay withholding taxes.

Reasonable cause may be a defense to the failure to pay over taxes due. Newsome, *supra*; Cash v. Campbell, 346 F. 2d 670 (5th Cir. 1965); Mazo v. United States, 591 F. 2d 1151 (5th Cir. 1979), cert. den. 444 U.S. 842 (1979); Wall v. United States, 592 F. 2d 154 (3rd Cir. 1979); Finley v. United States, 123 F. 3rd 1342 (10th Cir. 1997). However, mere delegation of responsibility to another does not constitute such "reasonable cause." Mazo at 1155. This includes a delegation to superiors as well as to subordinates. Howard at 2. Accordingly, Mr. Doe's delegation of responsibility by allowing Mr. Ron Doe to determine if taxes would be paid, or by leaving unexecuted checks for him to mail as Mr. Doe claims he did (Tr. pp. 53, 54) is insufficient to excuse Mr. Doe's failure to pay over the taxes due. As noted in Howard, *supra*:

When the Chief Executive Officer of a corporation puts another responsible person in the position of choosing between his duty to follow the instructions of the Chief Executive Officer or his statutory duty to remit employment taxes to the ... (government) ... a responsible person's election to do the former as opposed to the latter is made at his own peril. To hold that following the orders of the Chief Executive Officer is reasonable cause not to remit employment taxes would be tantamount to severely limiting the current broad reading of the term 'responsible person'. Such limitation is inconsistent with the

policy underpinnings of section 6672 that the ... (government) ... not suffer any unnecessary tax loss due to the failure of corporate collection agents to collect and pay over the employment taxes.

Howard at 2, 3.

WHEREFORE, for the reasons stated above, it is my recommendation that the Department's Notice of Deficiency No. 0000 be affirmed and finalized as issued.

Ted Sherrod
Administrative Law Judge

Date: December 12, 2002